

FACE TO FACE

MSCI: ‘Passive investing will be good for society’

HENRY FERNANDEZ

CEO of data provider  
defends inclusion of Chinese  
A-shares in EM index

CHRIS FLOOD

Henry Fernandez found China “an extremely primitive country” during his first visit in 1979 as a university student after a Time magazine article sparked his interest.

Almost four decades later, the Mexican-born chief executive of MSCI, the indices and data provider, remains fascinated by a country that has grown into the world’s second-largest economy. He is also clear-eyed about the goals of China’s leaders.

“The number-one goal of the Chinese leadership is the preservation of the Communist party and the stability of China. Everything revolves around that,” says Mr Fernandez.

Under his leadership, MSCI has grown into one of the world’s largest providers of indices that have around \$11tn in assets benchmarked against them globally.


Last week, after a long-running debate, MSCI decided to include mainland Chinese A-shares into its flagship emerging markets index for the first time, a decision Mr Fernandez says has received “an overwhelming level of support” from global investors.

MSCI rejected the inclusion of A-shares in 2015 and 2016 but agreed to admit a limited pool of 222 companies later this year following an extensive consultation process with its clients.

This landmark decision promises to have an enormous impact on capital flows into China, as many asset managers that use the MSCI emerging markets index as a benchmark will be compelled to buy more Chinese stocks.

A former diplomat in the Nicaraguan embassy in Washington who prides himself on speaking directly, Mr Fernandez has met many senior Chinese officials on numerous trips to Beijing since his first visit.





**Born** May 9 1958

**Total pay** \$8.2m (\$950,000 base salary)

**Education** 1975-79 BA (economics), Georgetown University  
1979-81 Economics doctoral studies, Princeton University  
1981-83 MBA, Stanford University

**Career** 1976-79 Third secretary, embassy of Nicaragua, Washington DC  
1983-91 Corporate finance, Morgan Stanley  
1991-93 Chairman and chief executive, Ferco Partners, Mexico City  
1993-94 President, HispaniMedia, Miami  
1994-2008 Managing director, Morgan Stanley  
1998 to present Chairman and chief executive, MSCI

“Members of the politburo and State Council have very long-term goals. They want to liberalise the renminbi and open up their capital markets. They also know that allowing investors to get out freely as well as buying in is very important. But they are also very focused on stability: political, economic and financial market stability. China will not take risks,” he says.

MSCI has been careful to specify that Beijing will need to undertake substantial further reforms to bring its stock markets closer to international standards before permitting any increase in the 0.7 per cent weighting for China A-shares in its emerging markets benchmark.

“We are hopeful that China will continue to open up over time so that this small inclusion of A-shares can grow into a larger allocation,” says Mr Fernandez.

Critics argue that MSCI’s decision will ensnare international investors in a corporate governance minefield of corruption scandals, murky ownership structures and company policies influenced by opaque state actors.

“There is no doubt that corporate governance standards need to be improved, but China is still an emerg-

ing market in the early stage of its development. We saw similar objections when Russia, Brazil, Indonesia and Mexico were included in MSCI’s emerging markets index. These governance concerns do not mean that it is impossible to find good companies to invest in,” says the father of three.

MSCI also said last week that it will consult over whether to include Saudi Arabia in its emerging markets index, another potentially controversial change.

Mr Fernandez says Saudi Arabia has been “off investors’ radar” but his meetings with the kingdom’s leadership, and a series of foreign-investor friendly reforms have convinced him that the country is undergoing a radical transformation.

“The senior leadership in Saudi Arabia is in a real hurry to diversify the economy away from fossil fuels and they need global capital markets to raise money to fund their reform programme.”

He believes that the mispricing of environmental, social and governance (ESG) risks is a problem across capital markets worldwide, not just in emerging markets.

“We are only just beginning to understand the impact of ESG risks

MSCI
Founded 1969
Benchmarked assets \$11tn
Employees 2,897
Headquarters New York
Ownership Listed on the New York Stock Exchange

on the long-term sustainability of an investment. Not a week goes by without companies in every part of the world being affected by ESG issues. There is no hiding place now because of social media and there will be a backlash over the next 10 or 20 years from employees, investors and regulators that will lead to a much greater divergence in the valuations of good ESG companies and bad ESG companies,” he says.

This interest in ESG has prompted friends of Mr Fernandez to criticise him for “turning socialist”, a charge he denies.

“Not every problem in the world requires a government solution. But we in the investment industry have a huge responsibility in lubricating the efficient allocation of capital to good companies,” he says.

Born in Mexico, Mr Fernandez now lives in New York, where MSCI is headquartered.

“That might not endear me to President Trump, as I must be taking a job from somebody in the US. But I am a very free-market immigrant,” he jokes.

Mr Fernandez has served as MSCI’s chief executive since 1998, during which time index-tracking investments have grown hugely in popularity at the expense of traditional active management, which seeks to buy assets that will outperform the market.

The shift into passive investments has helped to boost MSCI’s annual revenues from \$370m in 2007, when it first became a publicly listed company, to \$1.2bn. Annual net profits have increased from \$81m to \$261m over the same period.

Active management is “clearly in a long downcycle” in equity markets, says Mr Fernandez, but he willingly acknowledges the importance of its wider role in allocating capital.

“What planet are we on with this talk of the death of active investment? We are still far from creating efficient allocations across capital markets globally,” he says.

“Passive investing is another technological advance. It will free up resources to focus on less-efficient markets such as real estate, infrastructure and private debt. This will be good for society,” he says.